

10-11-1984
Release copies to DISTRICT

Date 11/26/84

Surname [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Key District: [REDACTED]
Employer Identification Number: [REDACTED]
Accounting Period Ending: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

The information submitted indicates that you are a Pool formed pursuant to a Joint Powers Agreement entered into pursuant to the provisions of [REDACTED] of the [REDACTED] Code. Parties to the Agreement include the public educational agencies of [REDACTED], [REDACTED], [REDACTED], and others who may at a later date become signatory to the Agreement. Your functions are: to provide a self-insurance plan and system for Workers' Compensation claims against member agencies and as such, to perform or contract for the performance of the financial administration, policy formulation, claims service, legal representation, safety engineering, and other developments as necessary for the payment and handling of all Workers' Compensation claims against member agencies as required by State law; to provide industrially-injured employees of your members all benefits required under Worker's Compensation laws; and to pursue any member's rights to subrogate to the rights of injured employees against a third party when appropriate. You have the power and authority to exercise any power common to the public educational agencies that are parties to the Joint Powers Agreement. [REDACTED] of the [REDACTED] Code provides that after completion of the purpose of the Agreement, any surplus money on hand shall be returned in proportion to contributions made.

Each member agency will pay to the Pool, each fiscal year, an annual premium calculated on the Workers' Compensation Inspection Rating Bureau rate multiplied by its estimated annual payroll, multiplied by its current experience modification factor. Should Workers' Compensation claims (including reserves) against all members exceed the total yearly premiums, your Board of Directors will assess each member an additional amount based upon the percentage of yearly premiums paid by each member relative to the total yearly premium paid by all members. You are a party to two reinsurance agreements which limit your liability for claims: one with [REDACTED] which includes a \$[REDACTED] deductible and \$[REDACTED] coverage per occurrence; and the other with

Section 501(c)(3) of the Code provides for the exemption of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes, and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.."

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to exempt purposes. An organization's assets will not be considered dedicated to exempt purposes unless, by reason of a provision in the organizing document or by operation of state law, upon dissolution such assets will be distributed for one or more exempt purposes or to the government for a public purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. Such term includes: relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(e)(1) of the regulations provides, in general, that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the facts and circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

Revenue Ruling 60-334, 1960-2 C.B. 172, provides that a wholly owned state or municipal instrumentality that is a separate entity and a counterpart of an organization described in section 501(c)(3) of the Code may qualify for exemption under that section.

Revenue Ruling 71-529, 1971-2 C.B. 234, states that a nonprofit organization that provides assistance and management of endowment and investment funds for participating colleges and universities for a charge substantially below the actual cost to the provider qualifies for exemption under section 501(c)(3) of the Code.

Revenue Ruling 72-369, 1972-2 C.B. 245, states that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code.

An organization is not recognized as exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test," the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and applicable regulations.

An organization operated for the primary purpose of carrying on a trade or business ordinarily carried on for profit does not qualify for exemption from taxation under section 501(c)(3) unless the service is provided to a participating section 501(c)(3) organization at a charge substantially below cost as described in Rev. Rul. 71-529.

Your provision of administrative and management services for member agencies with respect to their Workers' Compensation liability, and the related functions that you undertake in return for the premiums paid, is a trade or business of the type ordinarily carried on for profit. The

[REDACTED]

fact that the premiums are based on actual cost is not sufficient to characterize your activities as charitable within the meaning of section 501(c)(3) since the services will be provided at cost and not on a substantially below cost basis. See Rev. Rul. 71-529. Your primary activity of operating a self-funded Workers' Compensation pool is inherently commercial in nature and is not consistent with exemption under section 501(c)(3).

Further, your organizational document, the Joint Powers Agreement, neither limits your purposes to one or more exempt purposes nor permanently indicates your assets to exempt purposes. (Section 1.501(c)(3)-1(b) of the Regulations.)

Revenue Ruling 78-41, 1978-1 C.B. 148, is distinguishable from your situation since that case involves a trust created by, and operated as an integral part of, an exempt hospital. The hospital directs payments for the trust and makes all decisions concerning which claims to pay. The trustee merely acts as a disbursing agent. The hospital may also advise the trustee as to the investment of the trust funds within limits established in the trust document. This degree of control over, and involvement in the operation of the organization is not present in your case with respect to each of the participating member agencies.

Therefore, we conclude that you are not organized and operated exclusively for one or more of the purposes described in section 501(c)(3) of the Code. You are required to file federal income tax returns. Contributions to you are not deductible under section 170 of the Code.

However, in the event that you are a political subdivision of the State of California, or a wholly-owned instrumentality, contributions to you may be deductible under section 170(c)(1), to the extent provided in section 170(b). If you wish a determination as to whether you are an instrumentality or political subdivision, you should request a ruling from the Office of Chief Counsel, CC:IMD:I, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Such request should be filed in accordance with Rev. Proc. 84-1, 1984-1 I.R.B. 10.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 21 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request a conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Procedures.

[REDACTED]

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7423(b)(2) of the Code provides, in part, that a declaratory judgment or decree under that section shall not be issued in any proceeding unless the Tax Court, Claims Court, or District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Service.

If we do not hear from you within 21 days, this ruling will become final and copies will be forwarded to the District Director, San Francisco, California, which is your key district for exempt organization matters. Thereafter, any questions about your federal income tax status or the filing of tax returns should be addressed to that office. When sending additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope: [REDACTED]. These symbols do not refer to your case, but rather to its location.

In accordance with section 6104(c) of the Code, the appropriate state officials will be notified of this action.

Sincerely yours,

[REDACTED]
Chief, Exempt Organizations
Rulings Branch

7/24 ✓
cc: [REDACTED]

cc: [REDACTED]

cc: State Officials of [REDACTED]
[REDACTED]

Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
[REDACTED]	[REDACTED]				
[REDACTED]	[REDACTED]				
	10/18/84				

Pre-Approval and Clearance

Department of the Treasury / Internal